

Consultant's Report to Property Owners in Hidden Springs Resort

1. Scope of Work.

I was hired by the Board of Trustees of the Hidden Springs Resort in the summer of 2011, just after Richard Fraser turned the resort over to the owners and appointed a Board. I have worked with Boards and Associations for over 25 years in situations such as this.

The scope of work, as we defined it then, included several stages: 1. Evaluation of past financial records and an evaluation of Mr. Fraser's management of funds, 2. Consultation with the Board on proper procedures, ethics and communication. 3. Evaluation of the controlling documents for HSR. 4. Creation of a proposed budget for 2012. 5. Evaluation of Dues and Assessments. 6. Complete evaluation, in cooperation with a licensed engineer who knew the property well, of all facilities and amenities owned by HSR. 7. Determination of, and prioritization of, all maintenance needs. 8. Evaluation of HSR's current dues compared to other comparable resorts in the area. 9. Creation of a 30 year dues projection compared to projected maintenance costs for items beyond the ordinary budgeted upkeep. 10. Proposal for special assessments to cover the costs of projects needed to save the resort from immediate collapse.

2. First meeting with property owners.

On September 25th of 2011, a meeting was held in Sevierville, to which all property owners were invited, in order to present to them all information gathered in the preliminary evaluation stage. Reports were given by the management company, by Doug Yates, attorney for HSR, by Jimmy Taylor, Engineer and owner of ADG whose company has done much of the design work for Hidden Springs, and by myself, including a graphic presentation on possible assessment and dues scenarios, their impact on pressing maintenance and repair projects, and their impact on dues for the next 30 years of the life of the resort. The

presentation also included a report on the building of a Reserve Fund to help defray the cost of future maintenance needs.

Doug Yates answered several questions indicating that Richard Fraser had not mismanaged funds, and, in fact, had invested large amounts of his own money in the resort – money he lost when the economic downturn forced him to abandon the resort.

Jimmy Taylor explained in detail how desperate the water, sewer and roads problems were in Hidden Springs and made clear that the water problem was the most challenging. Water issues needed to be addressed immediately.

At that meeting, volunteers were sought to serve on several committees in support of the Board, including Budget and Design Review.

3. Budget meeting.

After an exhaustive study of the property and all its components and an evaluation by staff, engineer and consultant, a combined meeting of the Board and the Budget Committee was held at the resort to evaluate the physical condition and the financial condition of HSR. The combined group of 12 people, including 8 property owners, received the Consultant's/Engineer's report on the condition of the resort. Complete explanation of each aspect of the resort made it clear that HSR's water, sewer and roads were in near desperate condition.

A complete evaluation of the Proposed Budget was undertaken, line by line, in order to separate normal operational needs from major maintenance that could not be handled through a daily operating budget. A final Budget was approved for presentation to the membership.

Thorough evaluation and extensive discussion were held concerning major maintenance issues facing HSR. Water issues, which threatened to shut down the resort on either a short term or long term basis, were established as the first priority. Study of the possibility of connecting to city water were included in the discussion. As the attached letter from Jimmy Taylor makes clear, this is not a possibility for Hidden Springs, either from a financial or a legal standpoint. Pigeon

Forge simply will not allow such a connection under the current conditions. Even if they would, it would cost us 3.5 Million dollars. A combined program of digging a new, deep, well, bringing online an existing, unused 120,000 gallon water tank, purchase of new filter equipment, connecting all segments of Hidden Springs and Starrcrest into one system, and complete flushing of the HSR water distribution system was recommended, at a cost of \$150,000 to \$250,000.

An assessment of \$1000 per cabin was approved in order to begin work on this problem as soon as possible. Further assessment funds, to be paid later in the year, should cover the cost of this improvement if it goes over the minimum projected cost.

4. Sewer System.

If money is left over after completion of the water project, upgrades to the sewer system will be considered next. Our current system is inadequate to treat the wastewater generated by the resort, especially during peak times. Tennessee Wastewater has been working on our system in an attempt to upgrade its capacity.

Should that work prove inadequate, HSR may have to consider addition of another leach field. We would have to install this field, at our cost, then turn it over to Tennessee Wastewater to manage and maintain. The funds available to us through the \$2000 of special assessments would not be sufficient to do this project on top of the water issue, but it was the Board's hope that we would not have to address both major issues in a single year. If further assessments are necessary, it was hoped that they could be sought in future years.

5. Roads.

Local contractors advise us that the cost of completing the paving our roads would be in the \$1,000,000 range. As an earlier letter explained, our staff can maintain our roads with the knowledge, experience and equipment we have available. Thus, the Board felt it best to postpone this issue to a later date.

6. Reserve Funds.

The single most important move any homeowner's association can make is to begin aggressively funding a Reserve program. Healthy associations have sufficient money set aside to, essentially, self-insure against uninsurable and unforeseeable major events. The goal every HOA should set is to have enough money set aside such that no further special assessments should ever again have to be levied. If HSR had such a Reserve Fund, these major issues could be cared for by use of those reserve monies. Since you don't, and you inherited a resort facing some major hurdles, you are in the unenviable position of playing catch-up.

Nevertheless, it is vitally important that HSR begin its program of establishing its Reserve Fund, even while aggressively attacking its major problems. It is the Board's hope that the current assessments will allow the Association to begin to place money in safe investment accounts in order to fund your Reserves.

If you attended the September meeting, you saw the presentation which projected dues increases over 30 years. The only sample scenario that enabled you to meet your water and sewer problems, start building reserves such that, over the years, the fund would continue to increase in value, and still restrict dues increases to a minimal level, was the program that included a 10% dues increase each of the first 3 years, followed by 3% increases (these increases still leave your dues under the average for comparable resorts in the area). In addition, the \$2000 assessment would provide the "up front" money to address your major maintenance needs. If you did not face further major maintenance problems, and if your sewer system could remain viable, you would continue to grow more and more financially viable as the years went on. The attached sheets contain the dues projection analysis that will show you the effect of decisions that might have been made this first year. The first scenario shows that doing only a \$1000 assessment would leave you in the red for many years to come. The bottom one is the one closest to what we are actually projecting with the assessment as

presented to you. As you can see, this projection, with a one time only assessment of \$2000 improves things quite a bit, even if we have to spend money on the sewer system, but it does not build a great deal of money with which to work on roads in the future. The middle lines show what would happen if we did three straight \$1000 assessments. As you can see, it more than doubles the money available for future emergencies or major projects.

It is only fair to point out that, if your sewer system proves problematic, you might have to consider another assessment in order to resolve that issue. Your Board just did not want to add that cost to the current assessment until it could be determined whether or not the efforts by Tennessee Wastewater would prove to be effective.

7. Loan Money.

There are companies which loan money to HOAs for capital improvements and major maintenance problems. Some have questioned why we did not consider this avenue. In fact, we did.

The problem is that HSR still has too much in the “outstanding unpaid dues” account. These companies typically require only two items in order to qualify for these loans: 1. Accounts receivable under 6% and 2. a substantial Reserve Fund. Since HSR did not qualify on either count, an assessment had to be levied.

8. Questions from the ownership.

A. “Why was no vote taken?” Two reasons: 1. Under Article 4, Section 4.4 of your Covenants, the Board is given the right to levy such assessments as this one for purposes consistent with the current situation. 2. When Boards fulfill their responsibilities to their ownership, they cannot allow votes which would result in the collapse of the resort. Had the membership voted not to do an assessment in this case, the water issue could have reached crisis proportions that might have resulted in the necessity to close the resort. This is why the Board scheduled the September meeting in

order to get a feel from the owners about their willingness to accept a special assessment. Over 100 owners attended that meeting and no one objected to the assessment after hearing the presentation on the “State of Hidden Springs.”

B. “Why can’t we attach to city water?” Some have been deeply and vocally concerned that the Board did not study the possibility of getting connected to city water. The Board did study the issue, with the help of their engineer. His summary letter shows the reasons why it could not be done, without even reading beyond the first paragraph.

C. “Why change sewer rates for Phase 1 cabins?” Richard meant for this to be done, but it passed over due to an oversight. Equalizing the rates paid by all cabins seemed only fair.

D. “Is there a fairer way to assess sewer rates?” Probably so, and the Board is studying that issue. The difficulty to be overcome is to find a way to assess sewer rates more equitably without also increasing the cost to the HOA for monitoring water usage. Among possibilities being considered are: 1. Basing rates on the number of bedrooms, 2. Basing rates on the number of bathrooms or drains, 3. Basing rates on a percentage of water usage (which would require staff to constantly monitor water meters).

E. “Why was the second \$1000 assessed when it looks like the first \$1000 will cover the water problem?” The first \$1000 only covers the water problem if everybody pays promptly and the repairs cost only the minimum amount. If the solution to the water problem costs more than the minimum, or if the sewer problem becomes critical, and, if we want to begin to build our reserves, the additional money would be needed.

F. “Why can’t we make cuts in our budget?” First, this is our first budget and we don’t know how the year is going to play out. We

need to go through this year with a good “guesstimate” in order to learn what our real needs are. Second, the Board and Budget Committee went through the proposed budget line by line, discussing every item in order to try to find areas they felt we could cut. Everyone agreed that there didn’t appear to be any obvious choices.

G. “Why do we have so many people on our staff?” First, remember that they are all part time employees. Second, several of these people go back to the beginning of the resort. There is no way to overstate the importance of having people on staff who know how everything works, where everything is kept, where all the meters, valves and wells are, how the filtration system functions, how to grade the roads, etc. We don’t need to further complicate our situation by having new people trying to figure things out on the fly.

H. “Is there anything going on in our resort with Sally, Richard or the staff that is inappropriate?”

1. Sally does not own property in the resort. She is also not on the Board. She keeps separate books for the rental company and does not appear to have ever misappropriated funds or crossed the books. We are fortunate to have her.

2. Richard does own cabins in the resort. No HOA funds were used to build or maintain those cabins. All his property is in foreclosure. None of it can be sold to pay the HOA. He is one of the few, if not the only one, in foreclosure to have paid all his dues. He may have left us with a mess, but it was not malicious on his part.

3. All the book keeping, insurance and payment records for the staff seem to be clean and appropriate.

9. A final word.

I have worked with many Boards and many Board members over the years. You are fortunate to have the members you do have currently serving you. Please remember that these folks are volunteers. The number of hours they spend in your service is more than most of you would be willing to spend. They are conscientious and caring people, trying to do the right thing for Hidden Springs. They deserve your gratitude. They are not trying to “do something TO you” but rather “FOR you.” The assessments they levy hurt them as much as they do you, but they knew they had to be done, and were willing to take the heat for your sakes.

HOA Board positions are positions of SERVICE not positions of POWER. I consider your Board to be among the best I have ever worked with, and they did not know I was writing this. Please also be aware that these people are all newcomers to Board service and have a lot to learn in a short time. Please be patient with them.

Finally, I have recommended to them, and I do to you as well, that you alter your By-Laws such that you have 5 Board members rather than 3. There is just too much work to be done. I further recommend that some of you volunteer to serve as Alternates, with a voice but no vote, for a period of at least a year in order to have people ready to step on to the Board should sitting members have to resign. The Alternates would, at least, know something of Board procedure and practice when they become sitting Board members.

If you have special skills, experience as a Board member, or special knowledge of the resort and its system, the Board would like to hear from you.

10. The Future.

Obviously, a re-evaluation of the status of the resort will have to be made at the end of 2012. If the first part of the assessment is paid promptly by the vast majority of owners, work can begin early in the year to correct the water issue. It would be nice to get all that done before spring and rental season starts so we can flush all the pipes (close the resort) when fewer people want to be there. Only time will tell what

the condition and performance of the sewer system will be. We all fervently hope that we can make it through the year, or more, before having to work on that system.

There are many other smaller details that need attention. We hope to get to many of those this year too if our reserve money allows. Some of that, of course, can be done with daily operating funds.

Please do understand that your Board is very busy with the big picture items and be patient with the little things that drive you crazy until they can be addressed in more “normal” times.